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IN THE

Supreme Court of the United States

OCTOBER TERM, 1966

No. 1283

SEAS SHIPPING COMPANY, INC.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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New York, April 15, 1967

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Petitioner prays that a writ of certiorari be issued to review a decision of the United States Court of Appeals for the Second Circuit holding

(1) that the Tax Court did not err in using the barter-equation method of valuation to determine that the per share fair market value of a non-control block of stock had a premium value over its trading prices in an active market on the New York Stock Exchange;

(2) that the Tax Court erred, but harmlessly, when it (a) assumed that fair market value is a subjective quality varying with the particular owner of the property, (b) concluded that certain rights, received by petitioner in addition to the securities, enhanced the value of the securities, and (c) attached evidential weight to matters outside of the record; and

(3) that the Tax Court's decision evaluating the securities cannot be disturbed on appeal, notwithstanding errors in the method of evaluation applied, unless the Tax Court's ultimate conclusion is itself clearly erroneous.

Opinions Below

The opinion of the Court of Appeals, unreported, is set forth herein as Appendix A (1a-12a). The opinion of the Tax Court is reported at 24 CCH Tax Ct. Mem. 1222 (1965) and is set forth herein as Appendix B (13a-38a). The opinion of the Tax Court in a companion case, *Moore-McCormack Lines, Inc.* v. *Commissioner of Internal Revenue,* is reported at 44 T.C. 745 (1965) and is set forth herein as Appendix C (39a-67a). Some of the findings and the opinion in that case were incorporated by reference as part of the opinion in petitioner's case (15a; 24a).

Jurisdiction

The date of the judgment of the Court of Appeals was January 16, 1967. Judgment was entered the same date. The jurisdiction of this Court is invoked under Title 28, United States Code, Section 1254(1).

Questions Presented

1. May a Court of Appeals, in a property valuation case, properly classify, as harmless error, the use of a subjective standard of fair market value, reliance on evidence outside the record, and errors in reasoning, when all of the witnesses who valued the property using an objective standard reached a lower valuation figure than the Tax Court and where the Tax Court's valuation figure was the maximum the record even arguably permitted?

2. Does the "unless clearly erroneous" standard of review under FRCP 52(a) bar the Court of Appeals from reversing a decision if the lower court's result, reached through improper methods of evaluation, is one which might or might not have been reached through proper methods of evaluation?

3. Is the barter-equation method of evaluation a permissible one to use in determining the fair market value of a non-control block of 300,000 shares of a security which is actively traded on the New York Stock Exchange?

Statutes and Rule Involved

SECTION 1001(a) AND (b) OF THE INTERNAL REVENUE CODE OF 1954, TITLE 28 UNITED STATES CODE, SECTION 1001 (a) AND (b)

"Determination of amount of and recognition of gain or loss

"(a) Computation of gain or loss.—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

"(b) Amount realized.—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received. In determining the amount realized—

"(1) there shall not be taken into account any amount received as reimbursement for real property taxes which are treated under section 164(d) as imposed on the purchaser, and

"(2) there shall be taken into account amounts representing real property taxes which are treated under section 164(d) as imposed on the taxpayer if such taxes are to be paid by the purchaser."

SECTION 7482(a) OF THE INTERNAL REVENUE CODE OF 1954, TITLE 28 UNITED STATES CODE, SECTION 7482(a)

"COURTS OF REVIEW

"(a) Jurisdiction.—The United States Courts of Appeals shall have exclusive jurisdiction to review the decisions of the Tax Court, except as provided in section 1254 of Title 28 of the United States Code, in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury; and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in section 1254 of Title 28 of the United States Code."

RULE 52(a), FEDERAL RULES OF CIVIL PROCEDURE

"FINDINGS BY THE COURT

"(a) Effect. In all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon, and judgment shall be entered pursuant to Rule 58; and in granting or refusing interlocutory injunctions the court shall similarly set forth the findings of fact and conclusions of law which constitute the grounds of its action. Requests for findings are not necessary for purposes of review. Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses. The findings of a master, to the extent that the court adopts them, shall be considered as the findings of the court. If an opin-

ion or memorandum of decision is filed, it will be sufficient if the findings of fact and conclusions of law appear therein. Findings of fact and conclusions of law are unnecessary on decisions of motions under Rules 12 or 56 or any other motion except as provided in Rule 41(b)."

Statement

On March 1, 1957, petitioner agreed to sell ten ships, to be delivered at future dates, to Moore-McCormack Lines, Inc. (hereinafter Mooremac) for $5,466,668 in cash and notes and 300,000 shares of Mooremac stock. Petitioner agreed to hold the stock for investment. In computing the amount realized from the sale, the taxpayer assigned a fair market value of $19.90 per share to the Mooremac stock. Mooremac resold two of the ships during 1957 and, in computing its cost basis relative to the capital gains on the sales of the ships, Mooremac placed a value of $30 per share on the stock. The Commissioner determined deficiencies in the 1957 returns of both the taxpayer and Mooremac, both of whom petitioned to the Tax Court, pursuant to Title 26 USC §6213(a), for redeterminations of the deficiencies, and in due course the two matters were heard and decided by the Tax Court in separate proceedings. The Commissioner did not assert any particular value for the Mooremac stock but took the position that the value had to be the same in both cases. Each witness who testified as to the value of the stock agreed it was worth not more than $22.81 per share (Petitioner's Appendix in the Court of Appeals, 155a, 224a and 246a). The Tax Court, in separate decisions by Judge Hoyt, found in each case that the value of the stock was $30 per share (3a).[1] Each dollar per share added to the $22.81 had a tax effect on petitioner of $75,000.

[1] References are to the Appendices herein.

The Tax Court found that the sale of the ships was an arm's-length transaction and to a large extent appraised the stock by equating its value (plus cash and notes) with the value of the ten ships. It relied in part upon the sales contract itself. Although the taxpayer and Mooremac had put no total sales price in the contract, that instrument attributed individual dollar amounts to each ship; these values were used by the parties for the limited purpose of governing the parties' escrow arrangement, the possibility of *force majeure*, and the removal of two ships from the transaction at Mooremac's option. There was evidence to support the conclusion that the early 1957 fair market value of the individual ships was at least as high as the dollar amounts listed in the contract and the Tax Court so found. It added the dollar amounts ascribed in the contract to the individual ships, subtracted the amount of cash and notes, and equated the result—$9,000,000—with the total value of the 300,000 shares (3a).

There was a market for Mooremac shares on the New York Stock Exchange which the government's stock valuation experts considered satisfactory for establishing fair market value (5a) and the Tax Court found that the market established a readily ascertainable value for a few thousand shares of the stock (62a). The Tax Court considered these sales as relevant (62a) but found them not to have determinative weight in proving the value of the 300,000 shares petitioner received (5a). During the relevant dates in 1957 Mooremac shares were traded on the New York Stock Exchange at an average price of $22.81; the total trading volume for the year was 166,000 shares, and the annual high was $25.25, the highest price the stock had ever reached on the Exchange. If the taxpayer had resold its 300,000 shares at once, the Tax Court acknowledged petitioner would have received less than the trading price for small volumes—a phenomenon known as "blockage". The Tax Court, however, rejected the use of the trading price and blockage as determinants on the ground

that an annual market of 166,000 shares was too "thin" to fix the value of a block of 300,000 shares. The Court reasoned that a block of that size was worth much more than the sum of the trading prices of 300,000 individual shares because that number of shares constituted a 13% ownership in a successful corporation and was the largest block held by any Mooremac shareholder (5a). However, Messrs. Moore and McCormack together controlled a larger block and the Tax Court found them to be controlling shareholders. The Court also reasoned that the value of the shares to taxpayer was enhanced by virtue of what it termed "collateral rights", *i.e.*, (a) a contemporaneous voting trust agreement which it made with certain Mooremac shareholders by which the taxpayer received control of two directorships on Mooremac's board of ten for a period of five years in return for its promise to vote its shares for the other eight directors selected by the other parties to the agreement, (b) an agreement by Moormac to continue, under the same name, the shipping line previously operated by the taxpayer, and (c) an agreement by Mooremac to hire certain of the taxpayer's employees. Finally the Court noted that the book value of Mooremac shares during 1957 was in excess of $39 (5a-6a).

The Court of Appeals for the Second Circuit acknowledged that the Tax Court committed numerous errors:

(1) Blockage:

> "The Tax Court disregarded blockage on the ground that the taxpayer shareholder had no need or intention to liquidate its holdings. The court's underlying assumption—that the fair market value is a subjective quality varying with the particular owner of the property—is incorrect." (5a).

(2) Collateral Rights:

> "The court's treatment of the various 'collateral

rights' as enhancing the value of the stock is curious. It would appear to operate the other way. That is, if the consideration for the ships was paid in cash, notes, stock and other rights, the greater the value assigned to the cash, notes and other rights, the less would be the value assigned to the stock." (6a).

(3) Mooremac's Report to Shareholders:

"The Tax Court . . . attached evidential weight, as . . . [an admission] by Seas Shipping, to a report made by Mooremac to its shareholders . . . in which Mooremac stated that its stock was worth $30 a share. . . . [T]he record is barren of any evidence of ratification of or acquiescense by Seas Shipping in the statement. . . . [It] should not, therefore, have been considered as . . . [an admission] by the taxpayer." (6a-7a).

(4 and 5) Evidence Outside the Record:

"The Court . . . treated [as admissions] a representation made by Mooremac to the New York Stock Exchange that the stock transferred to Seas Shipping had a value of $30 per share, and (b) a statement made by Mooremac in a letter to Seas Shipping which referred to the price of the ships in dollars only. These two items are not in the evidence nor do they show up anywhere in the record of this case. It appears that they were arbitrarily lifted, together with numerous other findings, out of the companion case of *Moore-McCormack Lines, Inc.*, v. *C.I.R.*, 44 T.C. 745 (1965). . . . This was unsupported by a stipulation of the parties and was done *sua sponte* by the Tax Court itself. The free wheeling handling of the cases has resulted in an incomplete and somewhat disorderly record on review of this case. . . . [The statements] . . . should not . . . have been considered as admissions by the taxpayer." (6a-7a).

(6) Maritime Board Approval:

". . . [T]he court considered the fact that the Maritime Board in its approval of the sale of the ships, stated that the value of the stock was $30 per share. The parties in their briefs interpreted the Tax Court's references to the Maritime Board's approval of the agreement of sale as a conclusion of experts on the value of Mooremac stock. If the Tax Court did so, it was in error. . . .

"If, on the other hand, the Tax Court used the evidence of the approval of the agreement of sale only as proof that Seas Shipping, in accepting the approval, thereby admitted the $30 per share value, then the court was on perfectly sound ground." [footnote omitted] (7a-8a).

The Tax Court's findings show that it did not take the last mentioned approach:

"The petitioner objected to this language in the Maritime Board's letter and, together with Mooremac, sent a telegram to the Board requesting that the letter of approval be amended in such a way as would have eliminated the reference to a $30 price per share. The Maritime Board refused to change its letter, and the petitioner ultimately accepted it upon advice of counsel that the valuation of the shares for tax purposes would not be affected thereby." (15a).

The Second Circuit viewed the Tax Court's statements as to "collateral rights" and admissions to be mere makeweight and harmless error. The appellate court ruled in the alternative that

"It is wholly unlikely that the exclusion of these items of evidence would have altered the result in any way. Except for Mooremac's unilateral statements, they were not objected to and are only attacked as part

of petitioner's complaint on appeal against the Tax Court's method of evaluating the stock. This court cannot, however, disturb that court's conclusion unless it is clearly erroneous. *Maytag* v. *Commissioner,* 187 F.2d 962 (10 Cir. 1951)." (8a-9a).

Reasons for Granting the Writ

If the Second Circuit's decision in this case is allowed to stand petitioner has been deprived of the right to an ultimate finding of fact based on substantially correct standards for determining fair market value and of the right to an ultimate finding based on the evidence in *its* case. Moreover, the Second Circuit's decision is of importance generally as to the meaning of F.R.C.P. 52(a) which in relevant part provides that

> ". . . Findings of fact shall not be set aside unless clearly erroneous. . . ."

The Second Circuit has in effect ruled that a lower court's decision as to a finding of ultimate fact need not be set aside, although arrived at through the application of improper standards, if by applying proper standards to the preliminary findings, the lower court properly could, not would but could, have reached the same ultimate fact. That view of F.R.C.P. 52(a) is incorrect and has not been followed elsewhere. In *Municipal Bond Corporation* v. *Commissioner of Internal Revenue,* 341 F.2d 683 (8th Cir. 1965), the Eighth Circuit ruled that, when findings of fact are based on erroneous views of the law, the case should be remanded for new findings based on proper standards when more than one conclusion would have been possible. In view of this Court's special responsibility for reviewing questions under the Federal Rules of Civil Procedure, *Schlagenhauf* v. *Holder,* 379 U.S. 104 (1964), the writ should be granted.

The writ should also be granted in this case because of the importance of the issue of whether, under Section 1001(b) of the Internal Revenue Code of 1954 (herein the Code), it is proper to determine the fair market value of property received (a non-controlling block of Mooremac stock in this case) by determining the value of the property exchanged (ships in this case) where the property to be valued is traded on an active market (here the New York Stock Exchange). This Court has allowed the use of the barter-equation method of valuation in the absence of an active market. *United States* v. *Davis*, 370 U.S. 65 (1962). However, its use is unprecedented in the case of property actively traded. This Court should resolve this important issue which potentially affects the methodology to be used in the great number of property valuation cases which arise in administrative and judicial proceedings.

ARGUMENT

I.

In the Decision Below the Court of Appeals Has Deprived Petitioner of the Right to an Ultimate Finding of Fact Based on Substantially Correct Standards for Determining Fair Market Value.

The Tax Court found that the property petitioner gave up had a value which, when mathematically equated to the number of Mooremac shares petitioner received, results in a per share value of $30 for the Mooremac shares, the highest figure even hinted at in the record for the stock's value. Mooremac stock had never traded on the New York Stock Exchange for more than $25.25 per share. It thus becomes important to consider how the Tax Court treated those factors present in the case which tended to show that the highest possible figure was not the correct

one. The Tax Court undisputedly erred in its treatment of two of those factors—"blockage" and "collateral rights".

The Tax Court conceded that petitioner could not have obtained $30 per share for the block of stock it received but deemed that was irrelevant on the ground that petitioner had no plans to sell the stock. The Second Circuit acknowledged the Tax Court erred:

> "The Tax Court disregarded blockage on the ground that the taxpayer shareholder had no need or intention to liquidate its holdings. The court's underlying assumption—that fair market value is a subjective quality varying with the particular owner of the property—is incorrect. However, there would be no blockage in this case if there were a willing buyer—one who wanted to buy a block of 300,000 shares." (5a).

The Court of Appeals spoke no further on the issue and thus apparently concluded the error was harmless. But the Tax Court had arrived at the maximum possible ultimate finding, although there was not a scintilla of evidence that anyone was interested in acquiring petitioner's block of Mooremac stock, much less in paying a 33% premium over the Exchange price for it. Therefore, the property which petitioner received could not, with blockage appropriately considered, have a fair market value as great as it would have absent that factor. The Tax Court's error could not have been harmless.

The second admitted conceptual error of the Tax Court relates to its treatment of the "collateral rights". It should be noted that the Tax Court faced the difficult task of rationalizing how a non-controlling block of Mooremac stock, which traded at the relevant times herein on the New York Stock Exchange at a price of $22.81 per share, could have a 33% premium value over market prices. The

Court reconciled the difference by considering the collateral rights petitioner received. The Tax Court stated:

> "The shares which were received by Seas were received with certain additional rights and privileges which did not attach to the shares which changed hands on the stock exchange. The 300,000-share block received by Seas carried with it a promise by . . . [Mooremac] to continue to operate the Robin Line and to employ certain of Seas' key men 'in positions carrying responsibility and compensation comparable of [Seas].' It also carried the guarantee of . . . [Mooremac's] controlling shareholders that the 300,000 shares in the hands of Seas would control two seats on the board of directors for at least five years. These rights had some value above and beyond the value of the stock alone, as reflected in stock exchange prices, absent such collateral rights, and, hence, the mean stock exchange price is not determinative of the overall value of the 300,000 shares coupled with the bundle of collateral rights involved in this case. In the circumstances it is not unreasonable that the size of the block involved plus the collateral rights received in the transaction resulted in a per share value over $7 in excess of the weighted average stock exchange price of $22.81." (63a-64a).

The Court of Appeals correctly recognized this reasoning as error.

> "The court's treatment of the various 'collateral rights' as enhancing the value of the stock is curious. It would appear to operate the other way. That is, if the consideration for the ships was paid in cash, notes, stock and other rights, the greater the value assigned to the cash, notes and other rights, the less would be the value assigned to the stock." (6a).

But again the Court treated the error as harmless:

> ". . . it is apparent that the consideration given by the court to the rights accruing to the taxpayer from the contemporaneous voting trust agreement . . . was not a determinative factor in the decision, but was nothing more than additional make-weight. It is wholly unlikely that the exclusion of these items of evidence would have altered the result in any way." (8a).

In view of the high valuation figure reached by the Tax Court, it is submitted that the Court of Appeals assumes an omniscience it does not possess when it classifies as harmless the Tax Court's reasoning which attempts to reconcile its result with market prices. In any event the voting trust agreement, as opposed to certain other evidence, was a proper part of the evidence to be considered (no contention to the contrary has been made by petitioner) and the Court of Appeals cannot properly base its decision on what result might have been reached were that evidence absent.

The foregoing errors of the Tax Court were by themselves enough to call for remand of the case. The appropriateness of remanding the case is even more apparent in view of the Tax Court's admittedly improper classification of some of the evidence in the case as admissions and of its improper use of facts outside the record.

II.

In the Decision Below the Court of Appeals Erred in Ruling That, Under FRCP 52(a), a Lower Court's Ultimate Finding of Fact, Arrived at Through Invalid Criteria, Cannot be Disturbed Unless the Ultimate Finding is Itself Clearly Erroneous.

The Court of Appeals held that the Tax Court's treatment of the collateral rights received by petitioner, and the Tax Court's invalid interpretation of evidence and its improper use of extra-record material, were not determinative factors in the decision (8a). This ruling by the Court of Appeals was in the alternative. The errors were attacked as part of petitioner's complaint on appeal against the Tax Court's method of evaluation of the stock. After noting this, the Court of Appeals stated:

> ". . . This court cannot, however, disturb that court's conclusion unless it is clearly erroneous. *Maytag* v. *Commissioner,* 187 F.2d 962 (10th Cir. 1951)." (9a).

The citation of *Maytag* is undoubtedly to the following:

> "The taxpayer . . . directs our attention to the rule that the question of the proper criteria or criterion to be employed in determining the market value of property transferred as a gift is a question of law reviewable in the court of appeals. The criteria or criterion to be employed in a proceeding of this kind in determining the value of gifts is a question of law, and if it appears on review that the Tax Court employed the wrong or insufficient criteria or criterion in arriving at its determination of value to the prejudice of the taxpayer, the decision will be reversed and the proceeding remanded to that court. . . . But in order to warrant reversal of a decision of that kind it must

> appear that the error was prejudicial to the complainant on review. Even though the decision was based upon an erroneous rule of law, it will not be reversed if the findings of fact, governed by the correct rule of law, were sufficient to sustain the decision and had adequate support in the evidence." [Citations omitted.] *Maytag* v. *Commissioner of Internal Revenue*, 187 F.2d 962, 964 (10th Cir. 1951).

The Court of Appeals in the instant case seems to have interpreted the last sentence of that quotation, which itself is a quotation from *Helvering* v. *Rankin*, 295 U.S. 123, 133 (1935), to mean that reversal is not appropriate if the lower court could have reached the result it did through the application of proper standards. In *Rankin* the statement was *dictum* since the improper standard there involved was not shown to have in fact been used by the Board of Tax Appeals in deciding the case. It was also *dictum* in the *Maytag* case since the appellate court there, but not the court in the instant case, concluded that the result reached by the lower court was in fact the correct result.

The Eighth Circuit has, we submit correctly, not given the dictum too strict an interpretation. Thus, in *Municipal Bond Corporation* v. *Commissioner of Internal Revenue*, 341 F.2d 683, 690-91 (8th Cir. 1965), the court did not reach the question of what result the lower court could have reached but remanded the case to ascertain what result the court in fact would reach when proper standards were applied. We submit that the Eighth Circuit adopted the correct approach and that it is appropriate for this court to clarify or modify the *Rankin dictum*. Its application by the Second Circuit here has deprived petitioner of an ultimate finding based on a correct method of valuation. This was prejudicial since more than one valuation figure was permissible by the record and the Tax Court found the maximum value. The Tax Court's result pur-

ported to take all relevant valuation factors into account but expressly, and incorrectly, (1) ignored blockage, (2) attached improper significance to evidence and to matters outside the record, and (3) reasoned incorrectly as to the significance of the collateral rights involved in the case. These factors point towards a significantly lower fair market value than the Tax Court assigned.

III.

The Tax Court Placed Undue Emphasis on the Barter-Equation Method of Evaluating Property and the Court of Appeals Erred in Approving the Tax Court's Undue Emphasis.

To a very large extent, the Tax Court relied on the barter-equation method in evaluating the stock petitioner received. Such indirect method of evaluation has in the past been used exclusively in cases involving the evaluation of property for which there was little or no market (3a).

The Court of Appeals recognized the fact that there was "an active market for the property to be valued" (9a). The Tax Court conceded that the exchange price was valid for the purposes of ascertaining the value of at least a few thousand shares (62a).

An example of the type of case in which the barter-equation method has been upheld is *United States* v. *Davis*, 370 U.S. 65 (1962), which involved the evaluation of a wife's inchoate marital rights. Since there was no way to compute the value of such marital rights, the Court used what can be called the barter-equation method. It stated that, "Absent a readily ascertainable value [for the property received] it is accepted practice where property is exchanged . . . that the value of the two properties exchanged in an arm's-length transaction are equal in fact,

or are presumed to be equal." *Id.* at 72. The Court further stated that a rough approximation would be better than nothing.

The statutory test under Section 1001(b) of the Code is to determine the "fair market value of property (other than money) received". As the Court of Appeals recognized, one of the dangers of the barter-equation method is that the value of the property received may not be equal to the value of the property given up (4a).

The validity of this criticism is strongly suggested in this case. The Tax Court found that the property petitioner gave up had a fair market value which equates to a value of thirty ($30) dollars per Mooremac share received but the exchange price in an admittedly active market was $22.81 per share. (9a). Each expert witness who testified as to the value of the stock, including both Government stock evaluation experts, concluded that the per share fair market value of petitioner's block was no greater than the exchange price of $22.81 (Petitioner's Appendix in the Court of Appeals, 155a, 224a, 246a). The received block did not represent a controlling interest; the Tax Court recognized that Messrs. Moore and McCormack were Mooremac's controlling shareholders (63a). There was no indication that anyone would be interested in purchasing the block, much less at a premium. Indeed, the Court of Appeals acknowledged that petitioner would have received less than the market price if it had resold its 300,000 shares (5a).

In view of the foregoing, it is submitted that the Tax Court placed undue emphasis on the barter-equation method of evaluating property and this Court should grant a writ of certiorari for the purpose of establishing guidelines governing the use of the barter-equation method.

Conclusion

The errors of the Court of Appeals thus raises important questions concerning the Federal Rules of Civil Procedure and the Internal Revenue Code which deserve decision and reversal by this Court. The decision below has seriously misinterpreted the standard of review under FRCP 52(a) and has erroneously accepted as permissible the Tax Court's undue reliance on the barter-equation method of evaluating property. These issues affect the methodology to be used in a great number of property valuation cases as well as in a great number of cases involving appellate court review of lower court rulings. Review by certiorari should therefore be granted.

Respectfully submitted,

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New York, N. Y.,
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